The chart of the earning assets of the System demonstrates clearly that once the exigencies of the war period arose, there was no hesitancy upon the part of member banks to make heavy demands upon the facilities of the reserve banks. Indeed, as the momentum gained force, many bankers in their eager rush to meet the requirements of their customers lost sight of the earlier scruples concerning borrowed money and the pendulum swung to the other extreme. Instead of seeking rediscounts the officials of the System found themselves striving to conserve the financial resources of the country.

The general impression prevails that the War caused a development of the Federal Reserve Banks during the seven years of their operation that probably would not have occurred in many times that number of years under other circumstances. Study of the early functioning of the System bears out that assumption. The early operations of the banks also call to mind the point that they were less far-reaching in their influence. Business getting efforts are forgot or nearly forgot. But what was, may, perhaps, merely presage what is to come. Under stable conditions, the Reserve Banks may make smaller profits, but they will not serve a less useful purpose. Commercial banking must respond to and reflect the activities of business. In times of great activity, whether seasonal or cyclical, the Reserve Banks will be called upon to meet a corresponding demand. In the usual process of business they will have recourse to open-market operations. Through these operations they may exert a great and important influence on the commercial banks, on interest rates and on business activity.

The Federal Reserve System, State Banks and Par Collections

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FULL accomplishment of the purpose of the Federal Reserve Act, to provide a means whereby the strength and resources of the numerous independent banks of the United States would be made effective for concerted or coöperative action for the protection of the banking system and the service of the nation's commerce, industry and agriculture, depended upon membership of a very considerable proportion of the banks of the country. The provision of the Act making membership compulsory for national banks, brought at once into the System about 7,600 national banks with capital and surplus of $1,788,000,000 and total resources of $11,492,000,000, thus giving a membership at the outset comprising 42.6 per cent of the total banking resources of the country. But the provision for the admission of state institutions was merely to the effect that they might, upon application, be permitted to become members, subject to regulations of the Federal Reserve Board, and should then have the rights and privileges of other member banks.

STATE INSTITUTIONS SLOW TO JOIN

Contrary to general expectation, the problem of state bank membership was found complicated. Most of the state

institutions were either passive or opposed to the plan of the Federal Reserve System. At any rate, they were not disposed to seek membership therein. The number of such members at the close of 1916 was thirty-seven, of which only seven had a capital and surplus of over $1,000,000. In 1917, however, an amendment to the Act gave the state institutions assurance by statute, instead of by mere regulation of the Federal Reserve Board, that as members they might continue to carry on their banking business in substantially the same manner as they had previously done. It also gave them the definite right to withdraw from the System upon six months' notice.

Coincident with the legislative removal of obstacles to membership, the entrance of the United States into the World War gave a new and very strong impetus toward membership. The necessity of strengthening the banking system of the country to the maximum degree possible, in order to meet the strain of war financing, led President Wilson in the autumn of 1917 to make a strong appeal to state banking institutions to join the Federal Reserve System. The officers of Federal Reserve Banks, pursuant to what they believed to be their duty in the circumstances, carried the appeal to the individual institutions, without, however, bringing pressure upon them to join. Many of the more important ones responded and during the fall of 1917 and the first half of 1918, a considerable number of state institutions throughout the country became members. The movement was particularly noteworthy with respect to the aggregate of resources which thus augmented the strength of the System. The major portion of the large institutions in New York City entered the System promptly, and the close of the year 1917 found the System with a state bank and trust company membership of 250, having aggregate capital and surplus of $520,000,000, and aggregate resources of about $5,000,000,000. At the end of 1918, 936 state institutions were members with total resources of over $7,000,000,000.

Membership Shows Continued Increase Since the War

With the end of the War naturally came a slowing down of the efforts of the Reserve Banks to convince state institutions of the importance of taking membership in the Federal Reserve System, and during the past year such efforts have been practically discontinued. But there has been, nevertheless, a continuous and substantial movement of state institutions into the System. The laws of many states contained provisions concerning reserves, character of investments or other vital matters which have hindered or prevented institutions in those states from taking membership in the System, and, as these obstacles have from time to time been removed, more and more state institutions have taken advantage of the opportunity to join. Many states, for example, have now passed laws providing that a state institution, becoming a member of the Federal Reserve System, need keep only the legal reserves required by the Federal Reserve Act. The influence of this factor is strikingly illustrated in California where 61 institutions with total resources of $1,110,000,000 have become members in the eighteen months following the amendment of the state law in respect to reserves to be carried by member banks.

Present Membership of State Institutions

Some of the state institutions which became members during the war

period, did so with the intention of withdrawing at the end of the War, but their experience as members was evidently such that they did not deem it necessary to carry out this intention, for up to the present time only 37 with resources of $34,500,000 have withdrawn from the System. On the other hand, the number of such members has steadily increased and now amounts to 1,625, with total resources of $9,959,000,000, giving to the System a membership which now represents, it is estimated, about 69 per cent of the commercial banking resources of the country. Approximately 9,000 state institutions with aggregate resources of some $9,000,000,000, not now members, are eligible for membership, from which it appears that 53 per cent of the resources and 15 per cent of the numbers of the eligible state institutions are now in the System. The distribution of state bank membership by districts, is as follows:

DISTRIBUTION OF STATE BANK MEMBERSHIP BY DISTRICTS

District	*Number*	*Capital*	*Surplus*	*Total Resources*
			(In thousands of dollars)	
1. Boston	41	36,411	38,951	709,890
2. New York	134	187,255	190,561	3,903,409
3. Philadelphia	48	25,821	48,738	390,902
4. Cleveland	113	64,436	79,344	1,041,392
5. Richmond	62	15,160	9,798	152,271
6. Atlanta	116	27,025	17,271	323,928
7. Chicago	364	101,012	85,092	1,753,034
8. St. Louis	102	30,203	22,081	400,809
9. Minneapolis	133	10,747	3,994	126,369
10. Kansas City	60	13,335	4,272	178,032
11. Dallas	205	16,500	6,598	128,288
12. San Francisco	217	57,625	25,218	900,811
[1] Total	1,595	585,530	531,918	10,009,135

[1] Latest available itemized figures.

ATTITUDE OF NON-MEMBER INSTITUTIONS

Banking is essentially one of the most conservative of callings, and it is not surprising that there are many state institutions which have not as yet entered the Federal Reserve System and whose not having done so may be ascribed probably to two main causes:

1. The belief that membership in the System involves burdens or expense disproportionate to the advantages received in return, some of which, such as the avoidance of the old-fashioned money panic and the stabilization of banking conditions, they enjoy without membership. The fact that the Federal Reserve Banks do not pay interest on deposits whereas their city correspondents and reserve agents do pay interest on deposits is one of the apparent expenses which they fear to assume.

2. Opposition to the plan of par check collection which the System has established and developed.

EXPERIENCE OF MEMBER INSTITUTIONS

Most members of the System are now convinced that membership does not involve a burden or expense to a member bank, but, on the contrary, enables it to conduct its business in a more economical and efficient manner, entirely irrespective of the advantage of the rediscount facilities. The loss of interest is offset by the reduction in the amount of reserve which member banks were required to carry. For example, a so-called country bank

under the National Bank Act formerly carried a reserve against both demand and time deposits of 15 per cent, of which 9 per cent might be on deposit with approved reserve agents, and at least 6 per cent must be held as cash in vault. Assuming deposits of $1,000,000, all payable on demand, the bank would carry in vault at least $60,000, upon which it would earn nothing, and with correspondents, $90,000 upon which it would probably receive interest at 2 per cent, or $1,800 a year. The Federal Reserve Act reduced the bank's reserve requirement to 12 per cent, or $120,000, on which it would receive no interest, but which would give it the opportunity to loan the $30,000 released, say at 6 per cent, which would yield $1,800 and thus compensate for elimination of interest on the reserve balance.

In 1917 the required reserve against demand deposits was reduced to 7 per cent, all of which was to be carried with the Reserve Bank and with no fixed requirement for vault reserve. Experience shows that this has permitted an average reduction in country bank vault cash of around 4 per cent, which, together with the reduction of the required reserve against time deposits to 3 per cent, made still greater the compensating advantage due to lowered reserves. Most of the states have passed laws permitting state institutions becoming members to take advantage of these reduced requirements.

With the certainty of being able to obtain cash by rediscounting at the Federal Reserve Bank, member banks have felt justified in investing their funds more closely, carrying as their emergency reserve, bankers' acceptances, commercial paper, or government obligations which could be realized upon at any time, and thus increasing their earning power.

The opposition to the System on account of the establishment of its par collection plan will be discussed incidentally in the following topic. But it may be said that members have found that the use of the check collection facilities of the System has reduced the length of time required for the collection of checks, and enabled them to close out many accounts formerly required, thus further increasing the proportion of their assets which may be invested.

Check Collection Before the Reserve System

An important feature of banking in the United States is the extent to which the use of bank checks has been developed. They are the most usual means of settlement in all classes of business, from the payment of small household bills to payments for the largest transactions of commerce and finance. The presentation and collection of the myriads of checks arising in the course of daily business, and drawn upon over 30,000 independent banks located in all parts of the country, creates a problem of great magnitude, especially as checks are commonly used to settle accounts not only in the places where they are payable, but are sent to distant points, making necessary the use of the mails for their collection.

Before the establishment of the Federal Reserve System, the collection of checks in this country was accomplished by special arrangements between commercial banks. It was customary for banks in the country and in the smaller cities having checks on out-of-town points, to send all such checks to their city correspondent, which would undertake their collection in consideration of the balances carried by the smaller bank with the city institution. It was customary, also, for the country bank to charge the

amount to its correspondent as soon as the letter was mailed, and to treat it at once as part of its legal reserve, this being permissible under the provisions of the then existing law. The city bank to which the checks were sent, having similar arrangements with many correspondents, was the recipient of a very large volume of checks for collection and inasmuch as it had usually undertaken to collect these checks without charge, it was itself under the necessity of finding a means of collecting them with as little cost as possible. The obvious and simple method of sending the checks direct to the banks upon which they were drawn was not attractive because of the fact that the custom had grown up in many, though not all, sections of the country for the smaller banks which received checks on themselves through the mail, to make a charge for remitting to the sending bank for such checks, the rate of the charge varying with different institutions and running from $1 per thousand dollars, to as high as $3.50 per thousand dollars in some cases.

This charge was known as "exchange," and was made on the theory that the bank paying the checks performed a service for the bank from which the checks had been received in paying the latter with a draft on a bank in some large center. The value of this service was based upon the approximate cost of making shipment of currency to make the payment, plus postage and stationery, on the theory that payment of a bank check can be demanded only at the bank's counter, and that if remittance is made to a distant point, an additional service is performed. In order to avoid, so far as possible, the necessity of paying "exchange" for the collection of checks, it was usual for banks receiving checks from their correspondents to send them on to some other bank for deposit and collection, charging the remittance to the latter's account, and treating it at once as legal reserve. This effort to find a means of getting the check paid without deduction for exchange, led to checks' reaching their place of payment by very circuitous routes with much delay in the time of presentation and collection, and with increased risk of loss to the indorsers of the checks. By this means, also, the same check might be counted as reserve at the same time by several different banks, although as a matter of sound banking principle, it should not have been counted as reserve for any bank until actually collected.

These unsatisfactory check-collection practices, and the fact that the charges made, as well as the loss due to slowness in collection, fell on the commerce and industry of the country, led to action by Congress which, in passing the Federal Reserve Act, included provisions requiring Federal Reserve Banks to receive on deposit at par from member banks or from Federal Reserve Banks, checks or drafts drawn on any of their depositors, and authorizing them to receive for purposes of exchange or collection, checks or drafts payable upon presentation within their districts. The Act also authorized the Federal Reserve Board to require each Federal Reserve Bank to exercise the functions of a clearing house for its member banks.

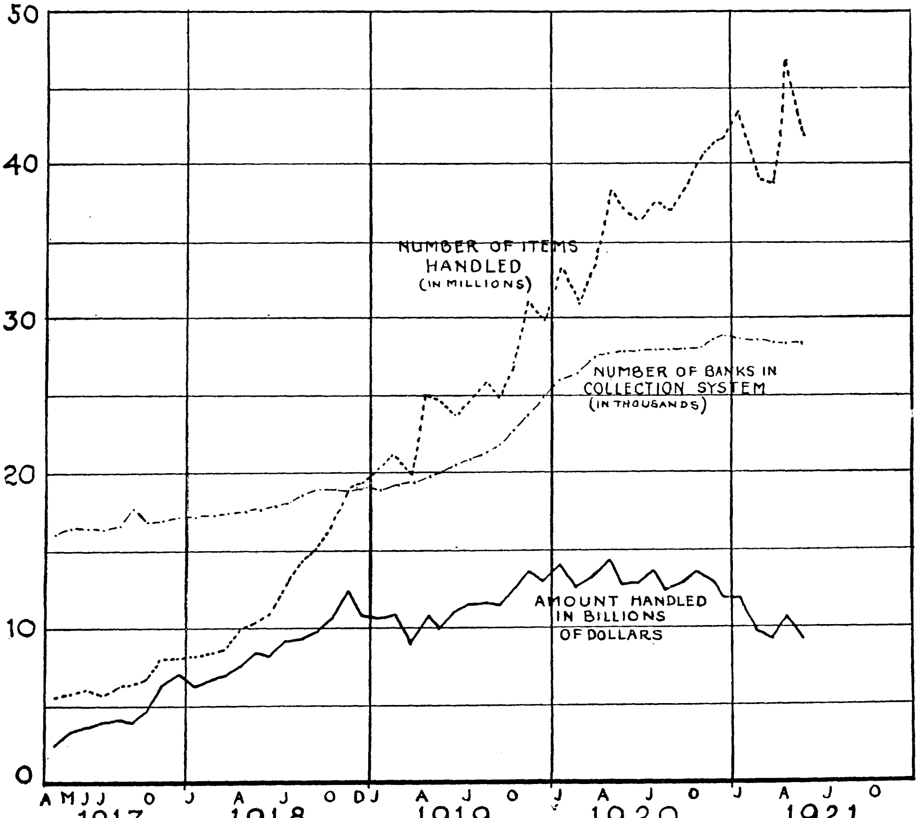
GROWTH AND ADVANTAGE OF THE PAR COLLECTION SYSTEM

The Federal Reserve Banks did not at once actively engage in the collection of checks under the provisions of the law above referred to, because the development of a comprehensive check-clearing plan presented many difficulties, and it was not until July, 1916,

that active operations were initiated. At that time a plan of operation was adopted which, recognizing that checks are payable at the counter of the paying bank, provided that the Federal Reserve Banks, in forwarding checks to a bank for payment by remittance, would pay the cost of currency shipped in payment for the checks, whenever tion through the mail equivalent to presentation at the bank's counter.

Operations under this plan have been highly successful, as will be gathered from the following chart showing the number and amount of items handled each month by the Reserve Banks, and the number of banks in the collection system.

GROWTH OF FEDERAL RESERVE COLLECTION SYSTEM
(By units of one month)



the paying bank elected to make payment in that way, and would also under certain conditions, especially for non-member banks, supply necessary postage and stationery, thus eliminating the elements of cost, which would otherwise fall upon the bank making the remittance, and making presenta-

The importance and desirability of the check-collection system which has developed and is now being operated by the Federal Reserve Banks, may be inferred from the extent to which the chart showing the volume of checks handled indicates that these facilities are being availed of by banks

which are members of the Federal Reserve System. They are also being availed of indirectly by non-members. The volume of items handled has grown steadily since the initiation of this method of check collection, until at the present time it may fairly be said that an overwhelming majority of all out-of-town checks handled by banks are collected through the agency of the Federal Reserve System. The Federal Reserve check-collection system has reduced the average time of collection about one-half, by the practice of the Reserve Banks of sending checks direct to the paying bank, if within the same district, or through a Federal Reserve Bank or branch if outside the district.

Opposition to Par Collections

It is not to be supposed that the system eliminating "exchange" and bringing about the par collection of checks should have developed so generally without encountering serious opposition from banks which had formerly received substantial income from their exchange charges. A committee of the American Bankers Association has from time to time during the past five years been endeavoring to secure legislation from Congress which would permit banks to charge exchange against the Federal Reserve Banks. Not having been successful in this, banks in Georgia, Kentucky and Oregon have brought suits to prevent the Federal Reserve Banks from presenting checks at the counters of state banks and a number of the southern states have passed laws designed to prevent the Federal Reserve Banks from collecting at par checks drawn on state institutions.

Cost of Collecting Reduced

The effect of the development of this efficient system of check collection has been to obtain for the business interests of the country a much more prompt collection of checks than formerly, reducing the risk of loss through bad checks and reducing the amount of credit which sellers of goods formerly had to extend involuntarily during the very substantial time required to collect checks. There has been, moreover, an important direct reduction in the cost of collecting checks due to the removal of the so-called "exchange" charge, or the charge made by banks for remitting in payment of checks drawn on themselves, so that at the present time a very large proportion of the country's checks are collected without charge. The change which has taken place in the schedule of charges for the collection of checks may be illustrated by the reductions made by the New York Clearing House Association.

Before the passage of the Federal Reserve Act the charges made by New York banks for collecting checks on outside points were discretionary as to less than thirty cities and were fixed at $1 per $1,000 for nearby states and $2.50 per $1,000 for the more distant states. The rate of charge is now discretionary (which means that in most cases no charge is made) for eleven entire states and the District of Columbia, 25¢ per $1,000 for one state, 50¢ per $1,000 for thirteen states and $1 per thousand for twenty-three states, while twenty-eight important cities in which Federal Reserve Banks or branches are located are collectible at rates lower than those quoted for the remainder of their states.

It should be understood that the present charge made by the New York banks is not an "exchange" charge at all but is made to cover interest on funds, for which credit is given at time of deposit, for the time which will elapse before the items have been actually

collected. The former charge included not only this element but also an amount designed to enable the city bank to pay the deductions of "exchange" made by paying banks elsewhere.

TRANSFERS OF FUNDS

The elimination of seasonal and other variations in the level of domestic exchange between different parts of the country has also been accomplished as a necessary accompaniment to the development of the check-collection system, since in order that each Federal Reserve Bank might freely handle checks on other Federal Reserve districts, it was necessary to provide a means whereby the balances arising between the districts might be settled without the expense of gold or currency shipments. To meet this need there was established in 1915 a Gold Settlement Fund, made up of gold deposited by the twelve Federal Reserve Banks with the United States Treasury, ownership being transferred from one Reserve Bank to another as the need arises to settle obligations between them. The books are kept by the Federal Reserve Board at Washington, and the settlements of all obligations arising among the Federal Reserve Banks are made by book entry, thus obviating the necessity for inter-district shipment of gold. The Gold Settlement Fund has also made collected funds, that is, funds on deposit with banks in any part of the country, readily transferable to any other center without discount, either by use of the check-collection system or, if the funds are on deposit with a member bank, by telegraphic transfer through the Federal Reserve Banks, it being the custom of the Reserve Banks to handle these transfers over their inter-communicating private wire and without cost to the member banks concerned. The importance of the wire transfer facility may be inferred from the following figures, showing telegraphic transfers handled by the New York Reserve Bank during the years 1916–1920:

	Number	*Amount*
1916	2,971	$485,000,000
1917	10,302	6,768,000,000
1918	39,099	19,384,000,000
1919	82,321	18,245,000,000
1920	147,302	17,022,000,000

The settlement of obligations between districts has thus been made so easy, that there is no longer any occasion for premium or discount on the transfer of actually collected funds between different parts of the country.

A most important result of the development of this check-collection plan is the lessening of the possibility of breakdown in the operations of the country's check-collection system. It will be recalled that, in the panic of 1907, a situation arose in which it was impossible to get cash returns on checks sent for collection to banks in certain centers, and that the machinery of check collection and domestic exchange practically broke down. Such a development is extremely unlikely under the operation of the Federal Reserve check-collection system supported by the borrowing facilities which the Federal Reserve System makes available to member banks, and which should enable solvent banks, even in time of severe crisis, to make payment for checks which may be drawn upon them.

The Federal Reserve check-collection system, in short, provides the machinery necessary to accomplish with maximum efficiency the necessary function of presenting and collecting any number of bank checks which may result from the use of this most convenient instrument in the settling of transactions of every kind.